

## Production Exemption

Does your business manufacture, process, or fabricate goods that you'll sell? If so, you might qualify to buy some equipment and supplies without paying sales or use tax. This is called the production exemption.

### Businesses that qualify for the exemption

To be eligible for the production exemption, your business must:

- Engage in a qualifying production activity
  - Farming – including custom farming
  - Ranching – including custom ranching
  - Mining – including contract mining
  - Fabricating
  - Manufacturing
  - Processing – including processing tangible personal property for use as fuel to produce energy
  - Raising or maintaining wildlife or fish for taxable hunting and fishing activities
- Own the goods you produce. (If you're a custom farmer, custom rancher, contract miner, or an energy producer, you don't have to own the goods that are produced.)
- Sell the goods you produce. Either you or someone else must sell the goods at retail.
- Spend the majority of your time on qualifying production activities. This means that you spend more than 50% of your time and activities producing goods for sale.

A separately operated business segment can also qualify. It can be a division, branch, or even a cost center. You must keep separate accounting records for the business segment to qualify as a separately operated business segment. This includes recording income, expenses, wages, and assets of the business segment separately. You must also have employees dedicated to operating the separate business segment.

*Example:*

Your business spends 40% of its time manufacturing and 60% making repairs. Manufacturing is an exempt activity, but repairing someone else's property isn't. Because your business doesn't spend more than 50% of its time producing goods, you don't qualify for the production exemption. Your manufacturing activities might qualify for an exemption if you make them a separate operation.

### Businesses that don't qualify for the exemption

Generally, retailers and other service-related businesses (such as restaurants and dry cleaners) don't qualify. The production exemption is only for businesses that spend the majority of their time producing goods for sale.

Idaho law excludes the following businesses from the production exemption:

- Utility companies delivering products through pipes, wires, or mains to the place where the

- customer will use the product
- Publishers of tax-exempt literature
- Contractors improving real property

The production exemption isn't granted to individuals who don't operate a business.

*Example:*

Equipment for your hobby doesn't qualify for the exemption because you're not a business.

## **Purchases that qualify for the exemption**

An item qualifies for the exemption if it meets all the following requirements:

- Primarily used more than 50% of its time in the production process
- Necessary or essential – can't produce your goods without it
- Tangible personal property – must not become real property
- Allowable by law – not excluded from the production exemption by law or rule
- Directly used during the production process – after the beginning, and before the end of the process
  - This begins at the processing site, when the operator first handles the raw materials used in production.
  - The process ends at the later of
    - When you place your product in storage, even temporarily, to be prepared for shipment, *or*
    - When your product is ready to be sold in its final form.
    - *Note:* Farming and ranching have different beginning and ending points for the production process

Examples:

- You use a piece of equipment directly in the production process. It's necessary and essential, but only 45% of its hours are used in the process. The equipment doesn't qualify for the production exemption because you don't use it more than 50% of its time in the production process.
- Your motor vehicles, repair equipment, and administrative equipment and supplies aren't eligible for the production exemption because they're excluded by law.
- You use loading equipment to place your palletized finished goods onto a truck for shipment. The equipment doesn't qualify because it takes place after the goods have been placed in storage.

## **Special activities**

If you qualify for the exemption, items used in some activities are exempt, even though they're not directly used in production. These activities include:

### **Quality control**

Quality control is a necessary step of the production process in some industries. Its purpose is to maintain specific product standards. Equipment and supplies are exempt if they're integral and necessary to maintain specific product standards during a quality control function.

#### **Research and development**

Equipment and materials are exempt if they are used more than 50% of the time in an activity that advances knowledge or capability in creating or producing tangible personal property. See Idaho Code section [63-3622RR](#).

#### **Clean room environment in semiconductor manufacturing**

Equipment and materials are exempt if you use them:

- Exclusively in or to maintain the environment of a clean room, *and*
- For research and development or production of semiconductors.

This includes fixtures or improvements to real property that become part of the clean room.

#### **Pollution control**

Equipment and materials used to meet air and water quality standards are exempt. The standards must be set by a state or federal agency that has authority to set and regulate them. For producers, the exemption includes tangible personal property that becomes real property used to meet air and water quality emission standards.

#### **Clean-in-place systems**

Equipment used in clean-in-place systems in the food processing and food manufacturing industries qualify for the production exemption. The exemption applies to systems that:

- Have automated cleaning processes (i.e., no human intervention), *and*
- Don't need to be disassembled to clean the equipment.

#### **Buy without paying tax**

If you qualify for the production exemption, you can buy the following items without paying tax:

##### **Raw materials**

Raw materials that become an ingredient or component part of the product

Examples:

- Metals bought by a metal fabricator
- Logs bought by a lumber mill
- Potatoes bought by a French fry producer
- Feed bought by a cattle rancher
- Elk and food bought to maintain an elk herd for hunting packages you sell and charge tax on

##### **Chemicals and catalysts**

Chemicals and catalysts that cause a physical change or are used to remove impurities from a product. They don't become an ingredient or component part, but they qualify when they're used directly and consumed in the production process.

Examples:

- Chemicals used by a potato processor to remove impurities from the potatoes
- Chemicals used to refine metallic ores
- Chemicals used to strip oil and impurities from electronic parts
- Chemicals used in a clean-in-place system in food processing/manufacturing
- Gases used in welding to mold and join a product that's being fabricated
- Chemicals used in a research and development laboratory

#### **Equipment that's consumed**

Equipment and supplies, including hand tools, that are consumed or used more than 50% of the time directly in the production process and are necessary to the process.

Examples:

- A computer used to run manufacturing equipment
- Equipment used to run or regulate machinery in the production process
- Equipment and supplies used to perform a necessary quality control step to meet product standards
- Equipment and chemicals used in clean-in-place systems in the food processing and food manufacturing industries
- Cranes and lifts used to install production equipment
- Repair parts, lubricants, hydraulic oil, and coolants that become part of production equipment
- Fuel used in production equipment during the production process (e.g., diesel, gasoline, propane)
- Equipment, supplies, and fixtures used in a semiconductor clean room environment

#### **Safety equipment that's required**

Safety equipment and supplies required by a state or federal agency and used in a production area, such as:

- Hard hats
- Protective clothing
- Gloves
- Fire extinguishers used for the safety of your workers
- A first aid kit stored and used in the production area

### **Purchases that don't qualify for the exemption**

Even if you qualify for the production exemption, the following items are taxable:

### **Used in nonproduction activities**

Equipment and supplies used in nonproduction activities are taxable.

Examples:

- Maintenance and janitorial activities
- Office and administrative activities
- Selling and distribution activities
- Transportation activities, such as:
  - Moving property over roads, highways, canals, rivers, rail lines, through pipelines or slurry lines, or on aircraft
  - Moving goods, including partially completed goods, from one exempt processing location to a separate location that's part of the continuous exempt processing activity
  - Moving raw materials, except farm produce, from the point of origin to where the production process begins

### **Licensed motor vehicles and aircraft**

#### **Used to make repairs**

Machinery, equipment, tools, and other property used to make repairs is taxable.

#### **Tangible personal property**

Tangible personal property that becomes part of real property is taxable.

Examples:

- Equipment used more than 50% of the time to improve real property
- Materials that become part of real property

#### **Recreation-related vehicles**

Examples:

- Snowmobiles
- Off-highway motorbikes
- Motorcycles
- All-terrain vehicles (ATV's)
- Motor homes
- Travel trailers
- Park model recreational vehicles
- Truck campers
- Camping trailers

#### **Used to make items that you won't sell**

Machinery, equipment, tools, or other property used to make items that you won't sell is taxable.

### **Coatings or paint**

Coatings or paint used to protect and maintain equipment, including production equipment is taxable.

### **Safety equipment**

Safety equipment and supplies that aren't used in a production area are taxable.

Examples:

- First aid kit in the office
- Fire extinguisher in the shipping area
- Jacket or gloves used in a production area to keep an employee warm, but not required by OSHA

## **If you change the use of an item**

If you buy an item exempt to use in a production activity, it becomes taxable if you stop using it in a production activity. You must then pay tax on the fair market value of the item.

### *Example:*

You buy a forklift to move raw goods from one part of the factory to another during the production process. The forklift qualifies for the exemption because it's directly used in the production process. After two years, you move the forklift into the finished goods warehouse to load trucks. Loading trucks isn't part of the production process. The forklift is now taxable on its fair market value. You must determine the fair market value of the forklift, and pay use tax on that amount.

Note: The opposite isn't true. If you pay tax on an item because you use it in a nonproduction activity, you can't claim a tax credit if you begin to use it in a production activity.

### *Example:*

On January 1, you bought and paid tax on a forklift for the shipping warehouse. In July, you moved the forklift from shipping to the fabricating line (a nontaxable activity). You can't claim a credit for tax paid on a forklift if you move the forklift into a production activity from a taxable activity.

## **Logging, broadcasting, and publishing exemptions**

You might qualify for exemptions similar to the production exemption if your business is in the following industries:

- Logging
- Radio and television broadcasting – see Idaho Code section [63-3622S](#)
- Producing free newspapers (newspaper must contain at least 10% informational content) – see Idaho Code section [63-3622T](#)

## **Buyer's responsibility when making exempt purchases**

You must keep records of all your purchases, and show whether you paid tax on them.

- Records must show what you bought, how much you paid for the goods, and how much tax you paid.
- Your accounting records must include the standard books and records maintained in a business.
- Keep all your records for at least four years.

## Exemption certificates

To buy an item exempt from sales tax, give the seller a completed exemption certificate.

- [ST-101](#), *Sales Tax Resale or Exemption Certificate*. Fill in the form:
  1. Write the name and address of both the seller and your business at the top.
  2. In section 2 "Producer Exemptions," check the box for the producer exemption(s) you qualify for.
  3. List any products you produce on the line at the bottom of section 2.
  4. Under "Buyer," at the bottom of the page, sign the form. Fill in the rest of the fields (name, title, EIN or driver's license information, and date).
- Optional short version of ST-101
  - Retailers can print or stamp a short version of the ST-101 on sales invoices, **or**
  - Purchasers can print the short version on their purchase orders.
  - This shorter version must be completed for each sale. The wording must be:

I certify that the property I've purchased will be used by me directly and primarily in the process of producing tangible personal property by mining, manufacturing, processing, fabricating, or farming, or as a repair part for equipment used primarily as described above. This tax exemption qualifies if this statement is signed by the buyer and the name, address, and nature of the buyer's business are shown on the invoice. Any person who signs this certification with the intention of evading payment of tax is guilty of a misdemeanor.

[Indicate spaces for NATURE OF BUSINESS and SIGNATURE OF BUYER]

- If you buy from out-of-state businesses that are registered Idaho retailers, you can complete the [Uniform Sales and Use Tax Certificate - Multijurisdiction](#) instead of Form ST-101. Fill in the form:
  1. Write the name and address of both the seller and your business at the top.
  2. Check the box for "Manufacturer."
  3. Write your Idaho sellers permit number in the ID section.
  4. Sign and fill in out the bottom of the form.

Remember: Even if you buy from a seller who has your exemption certificate, not everything is exempt.

- Some items are always taxable.
- Some items are taxable if they're not used in qualifying activities.



## **Selling the goods you produce**

- If you sell the goods you produce to a retailer, don't charge sales tax if the retailer gives you a completed [exemption certificate](#) (e.g., ST-101).
- If you sell your goods at retail to the final consumer, you must charge tax. The only exceptions are if:
  - The item is never taxed in Idaho, or
  - The buyer gives you a completed exemption certificate.

## **Seller's responsibility to document sales**

If you're selling to producers with an exemption certificate, you must keep complete records to document all exempt and taxable sales. If you have a complete and accurate certificate on file, don't collect sales tax on purchases that qualify for the claimed exemption.

## **Use tax**

When you buy, use, or store taxable goods in Idaho, but didn't pay sales tax when you bought them, you owe use tax.

Use tax is often due when:

- You buy goods from an internet retailer that doesn't collect tax
- You buy a *taxable* item from a seller who didn't charge sales tax because the seller has your exemption certificate on file
- You buy an item in a state that doesn't have sales tax, then bring the item to Idaho
- You change how you use an exempt item (See [If you change the primary use of an item.](#))

Learn more about use tax on our [Sales/Use Tax page](#).

## Laws and rules

Learn more about production exemptions:

- Production Exemption (Idaho Code section [63-3622D](#); [Sales Tax Rule](#) 079)
- Farming ([Sales Tax Rule](#) 083)
- Underground Mining ([Sales Tax Rule](#) 081)
- Above Ground and Open Pit Mining ([Sales Tax Rule](#) 082)
- Lumber ([Sales Tax Rule](#) 080)
- Logging (Idaho Code section [63-3622JJ](#); [Sales Tax Rule](#) 102)
- Research and Development (Idaho Code section [63-3622RR](#))
- Clean Rooms (Idaho Code section [63-3622NN](#))
- Pollution Control Equipment (Idaho Code section [63-3622X](#))
- Certificates for Resale and Other Exemption Claims (Idaho Code section [63-3622](#); [Sales Tax Rule](#) 128)
- Use Tax (Idaho Code section [63-3621](#); [Sales Tax Rule](#) 072)
- Radio and Television Broadcasting Equipment (Idaho Code section [63-3622S](#); [Sales Tax Rule](#) 055)
- Equipment to Produce Certain Newspapers (Idaho Code section [63-3622T](#); [Sales Tax Rule](#) 127)

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